Profile of the Economy

[Source: Office of Macroeconomic Analysis]

Real gross domestic product (GDP)

Economic growth continued at a strong pace in 1999. Real GDP increased by 4.2 percent over the year. For the fourth year in a row, it exceeded the 4 percent mark. Not since the 1960s has such a consecutive string occurred. In February 2000, the expansion reached 107 months, making it the longest on record.

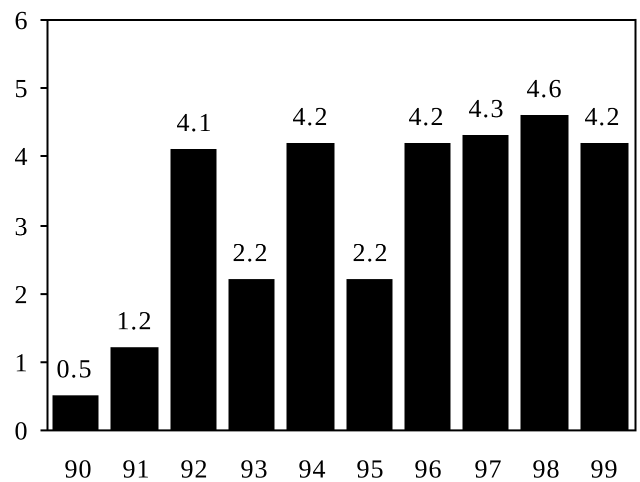
Growth accelerated in the fourth quarter of 1999 to a rapid 5.8 percent annual rate, based on preliminary estimates. Strength in that quarter reflected another large advance in consumer spending, continued increases in inventory investment and acceleration in Federal Government spending. Extra purchases and inventory building in anticipation of year 2000 (Y2K) disruptions may have boosted results slightly. However, the impact on real growth because of Y2K concerns appears to be fairly small.

The growing foreign trade deficit continued to drag on the economy in the fourth quarter of 1999, subtracting 0.7 percentage point from real growth. This decrease was the same as in the third quarter but less than the drag in the first half of 1999. Growth in business investment slowed in the fourth quarter because of continued declines in investment in structures and a smaller increase in purchases of equipment and software.

The national accounts measures of inflation accelerated in the fourth quarter. The GDP price index moved up at a 2.0 percent annual rate compared with 1.1 percent in the third quarter. The core rate, excluding food and energy, showed a similar acceleration. Over all of 1999, however, price growth was a moderate 1.6 percent.

Growth of Real GDP

(Percent change, fourth quarter to fourth quarter)



Inflation

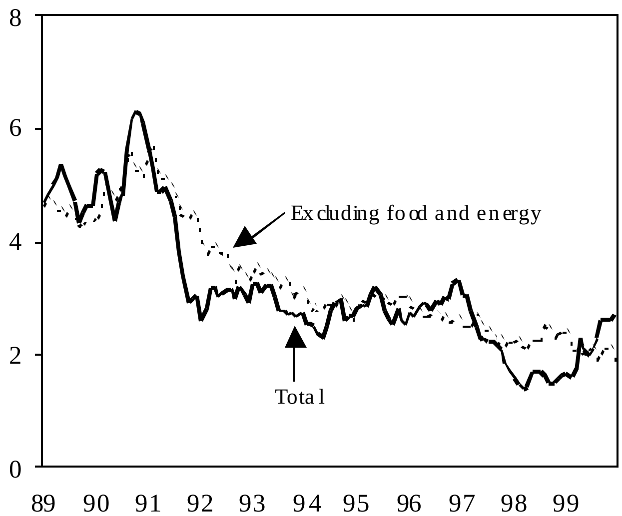
The inflation rate increased a little last year from the modest pace of the prior 2 years. The acceleration resulted from a turnaround in the energy area. Core inflation, excluding food and energy, slowed in 1999. Wage pressures were held down by strong productivity gains.

Consumer prices rose by 2.7 percent, following an increase of 1.6 percent in 1998. After declining by 15 percent in 1998, prices jumped by almost 30 percent for petroleum-based energy products in 1999. Core consumer price inflation slowed by one-half percentage point to 1.9 percent. That was the smallest yearly increase since 1965. Food prices also rose by 1.9 percent.

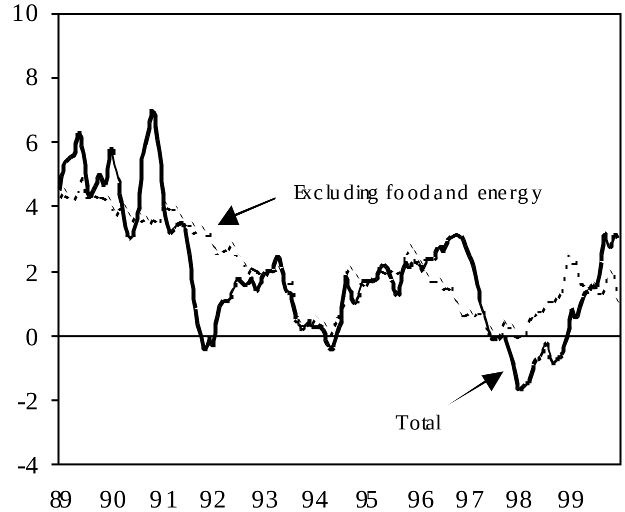
The pattern of producer prices for finished goods mirrored developments at the consumer level. The prices of finished goods remained unchanged in 1998 but grew 3.0 percent last year. Core inflation eased from 2.5 percent in 1998 to 1.9 percent in 1999. This slowdown was offset by a turnaround in energy prices. After declining by almost 12 percent in 1998, energy prices rose by more than 18 percent in 1999. Core prices for crude and intermediate goods increased, following declines in 1998.

Hourly compensation in the nonfarm business sector increased by 4.4 percent during 1999. That represented a significant slowdown from 5.3 percent during all of 1998. Productivity grew by a healthy 3.3 percent during 1999. This offset much of the rise in hourly compensation and limited the increase in unit labor costs to 1.1 percent. That was a 1.0 percentage point reduction in growth from the previous 2 years. The employment cost index for total compensation (a separate compensation measure computed by the Bureau of Labor Statistics) rose by 3.4 percent for the 12 month period ending in December. This was the same as in 1998.

Consumer Prices
(Percent change from a year earlier)



Producer Prices - Finished Goods
(Percent change from a year earlier)

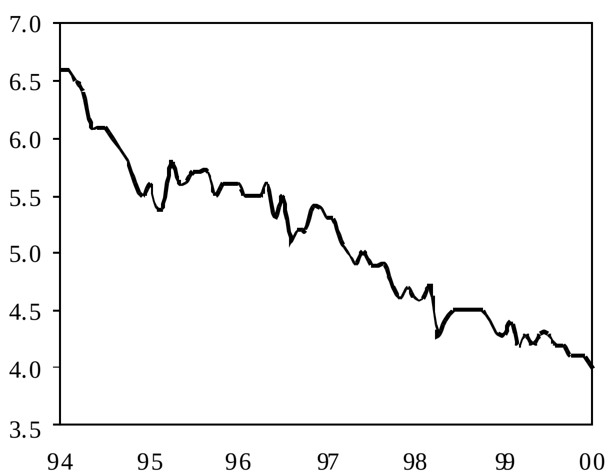


Employment and unemployment

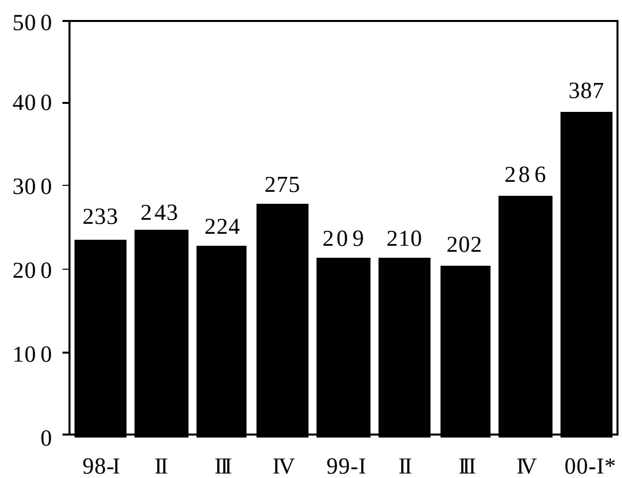
At the beginning of the first quarter 2000, labor markets remained buoyant. Job growth was strong and the unemployment rate declined to a new 30-year low. However, evidence of wage pressure was scant.

Growth of nonfarm payroll employment increased in late 1999 and remained strong into 2000. Job increases averaged 286,000 a month during the fourth quarter. This was significantly faster than the 207,000 averaged during the first three quarters of 1999. In January, employment soared by 387,000. In part, a surge in construction jobs on a seasonally adjusted basis resulting from mild winter weather contributed to these gains. Employment in manufacturing and mining rose after declines beginning in early 1998. Jobs in the private service-producing sector continue to expand rapidly.

Unemployment Rate
(Percent)



Establishment Employment
(Average monthly change in thousands)



*Based on January data.

The unemployment rate eased to 4.0 percent in January and was the lowest since the beginning of 1970, when unemployment stood at 3.9 percent. The share of the working-age population employed reached a record-breaking 64.8 percent in January 2000. According to these indicators, the economy continues to operate at a very high level of labor utilization.

Wage gains in nominal terms have remained surprisingly low. Although average hourly earnings of production workers and other nonsupervisory workers rose by a fairly strong 0.4 percent to $13.50 in January, earnings have advanced by only 3.5 percent over the past 12 months. This represents a slowing from the 12-month growth of nearly 4-1/2 percent in early 1998, which was an unusual development in a period of tight labor markets. Earnings rose by about 1 percent in real terms over the past year. This rise extended the positive readings of the past 5 years for the strongest performance since the early 1970s.

Real disposable personal income and consumer spending

Personal income rose by 7.2 percent in nominal terms in the fourth quarter of 1999. An increase in farm subsidies and a rebound in rental income after losses caused by Hurricane Floyd in the third quarter boosted this rise. During all of 1999, personal income increased by 5.8 percent in nominal terms, similar to 1998's growth. Increases in wages and salaries slowed to about 6 percent during 1999 from 7 percent during 1998. However, income from dividends and interest was stronger in 1999. In real terms, disposable (after-tax) personal income rose by 3.7 percent during 1999. That was down from just above 4 percent during each of the previous 2 years. The slowdown reflected higher inflation resulting from last year's jump in oil prices.

Real consumer spending rose at a 5.3 percent annual rate in the fourth quarter of 1999 and by 5.4 percent for the whole year. In 1999, large spending increases occurred for discretionary items such as furniture and appliances, recreational services and clothing. In January, record levels of consumer confidence suggest that the outlook for further gains in consumer spending remains rosy.

The greater increase in spending than in disposable income pulled the personal saving rate down further. It dropped from 2.1 percent in the third quarter of 1999 to 1.9 percent in the fourth quarter. This was the lowest figure in the history of the series, which dates back to 1959. The saving rate has declined steadily from a recent high of 8.7 percent in 1992. This was primarily because of the growing "wealth effect" resulting from the rise in the stock market. Increases in asset values are not counted as income in the national income and product accounts, from which the calculation of saving is derived. Nonetheless, increases in asset values contribute to the willingness of consumers to spend.

Industrial production and capacity utilization

Industrial production in manufacturing, mining and utilities rose by 4.7 percent over the 12 months of 1999. This growth nearly doubled the tepid 2.5 percent gain recorded during 1998. Acceleration in 1999 reflected a higher level of activity in the manufacturing sector, which turned in a relatively weak performance the previous year. It also reflected a mining industry turnaround from the sharply curtailed output in 1998.

The momentum in 1999 carried into 2000. Total industrial output surged by 1.0 percent in January. Manufacturing production accounts for almost 89 percent of total industrial output. It grew by 0.9 percent in January, building on the 4.9 percent rise in 1999. The strong January advance stemmed primarily from the durable goods producing sector where large gains were recorded in the motor vehicles and parts and high tech industries. Production in the mining industry increased by 1.0 percent in January, reflecting the ongoing recovery in oil and gas extraction. In February 1999, oil and gas extraction bottomed out after a year of sharp declines brought on by falling oil prices. Since then, output in that industry has increased by 6.9 percent.

Substantial production gains combined with slower capacity building continued to lift the industrial capacity utilization rate at the beginning of 2000. This rate increased by 0.5 percentage point in January to 81.6 percent, the highest level since August 1998. Consequently, the capacity utilization rate is now just 2.8 percentage points below its cycle high of 84.4 percent and only one-half point below its long-term average of 82.1 percent.

Nonfarm productivity and unit labor costs

Nonfarm business productivity (real output per hour worked) surged at a 5.0 percent annual rate in both the third and fourth quarters of 1999. During all of 1999, productivity advanced by 3.3 percent (measured fourth quarter to fourth quarter), its strongest increase since 1992. More important than a single yearly reading, however, is the fact that growth over the past 4 years averaged a rapid 2.8 percent annual rate. This is nearly double the 1.5 percent pace averaged from 1973 to 1995.

Hourly compensation costs in the nonfarm business sector rose by 4.4 percent during 1999, down from a 5.3 percent increase during 1998. The large gain in productivity offset most of the rise in the cost of compensating labor. As a result, labor costs per unit of output rose by only 1.1 percent during 1999.

This represented a slowing of approximately 1 percentage point from growth of about 2 percent annually during the previous 2 years and was an important factor in restraining inflation.

Productivity in the manufacturing sector also had a banner year in 1999. Factory output per hour soared at a 10.7 percent annual rate in the fourth quarter, bringing the increase for the entire year to 6.9 percent. This was the strongest annual performance in the 41-year history of the series. Hourly compensation costs in manufacturing rose by 5.1 percent during 1999, but the increase was more than offset by rising productivity. As a result, unit labor costs in this sector fell by 1.7 percent during 1999. This extended a 6-year declining trend that has reduced factory unit labor costs by a total of 8.0 percent.

Current account balance

The current account summarizes U.S. international transactions, measuring trade in goods and services as well as the net flow of investment income and net unilateral current transfers. Except for a surplus of $4.3 billion in 1991, the current account has been in deficit almost continuously since the early 1980s. Since 1991, the deficit widened substantially. It reached a record high in the first three quarters of 1999 of $319.3 billion at an annual rate. That represented a 3.5 percent share of GDP, an all-time high.

Over the past several years, U.S. economic growth has outpaced that of our major trading partners, causing imports to grow much more rapidly than exports. The sharp appreciation of the dollar from 1995 to 1997 widened the trade gap further. Deterioration in the current account balance has primarily reflected a deepening of the deficit on trade in goods, which swelled to $368.6 billion at an annual rate in the third quarter of 1999. In 1999, higher prices for imported oil contributed to that deterioration. In addition, a positive balance on investment income shifted to a negative as the inflow of capital into the United States boosted payments of earnings and interest to foreigners. The total current account deficit was $359.8 billion at an annual rate in the third quarter.

The current account deficit is matched by offsetting transactions in the financial and capital accounts, plus a statistical discrepancy. In third quarter 1999, the financial account recorded a net inflow of $422.7 billion at an annual rate. This was because financial inflows for foreign-owned assets in the United States far exceeded financial outflows for U.S.-owned assets abroad. Net capital account transactions were $0.7 billion at an annual rate, and the statistical discrepancy was -$63.6 billion.

Exchange rate of the dollar

The exchange rate of the dollar against a broad index of currencies of important U.S. trading partners was fairly steady in 1999 and early 2000. This steady performance contrasts with 1998. In August 1998, the value of the dollar spiked because of global financial uncertainty and then dropped back sharply once the crisis had passed. Until that crisis, the dollar had consistently appreciated against the broad index of important trading partners since 1995.

The exchange rate of the dollar against a more narrow range of currencies of major U.S. trading partners followed a similar pattern as the broad trade-weighted index but was somewhat more volatile. These currencies consist of the euro plus those of other major partners such as Canada, Japan and the United Kingdom. The dollar appreciated against the major currencies index by almost 5 percent from January 1999 until July. Then it dropped about 4-1/2 percent through October before moving back up 3.4 percent by the middle of February.

The relatively flat performance of the dollar in 1999 against the aggregate index of major currencies masked divergent patterns among individual currencies. The dollar appreciated by more than 14 percent from January 1999 to January 2000 against the euro, but depreciated against the yen. Since its most recent peak in August 1998, the exchange rate of the dollar against the yen fell by more than 27 percent through January 2000. The yen has strengthened amid expectations that a recovery in the Japanese economy is imminent. In addition, strong foreign interest in Japanese equities helped augment the yen's rise.

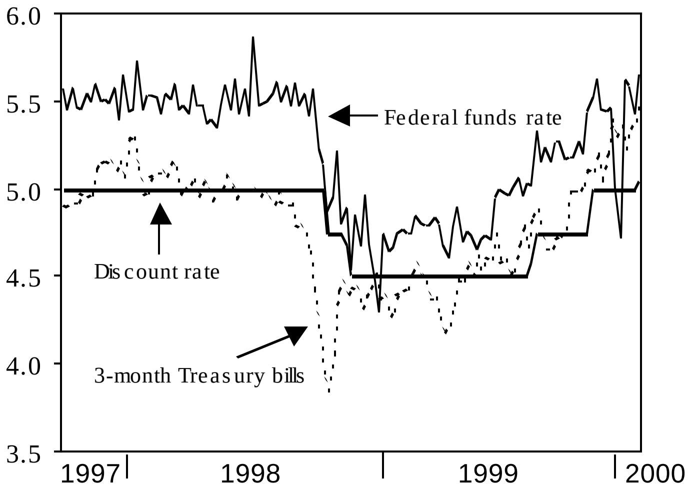
Interest rates

The Federal Reserve increased short-term interest rates three times in 1999. This reversed the easing moves made in 1998 during the period of global financial turmoil. In February 2000, the Federal Reserve increased short-term rates by another 25 basis points. It cited concerns that a continued trend of faster growth in economic demand compared to potential supply could foster inflationary imbalances. The latest move brought the federal funds target rate (the rate that banks charge one another for overnight borrowing) to 5.75 percent, 100 basis points (1 percentage point) higher than its level in February 1999. The discount rate (the rate the Federal Reserve charges banks for short-term funds) was raised to 5.25 percent, 75 basis points (3/4 percentage point) higher than a year earlier. The market interest rate for the 3-month Treasury bill, usually centered around the discount rate level, was about 5.5 percent in early February.

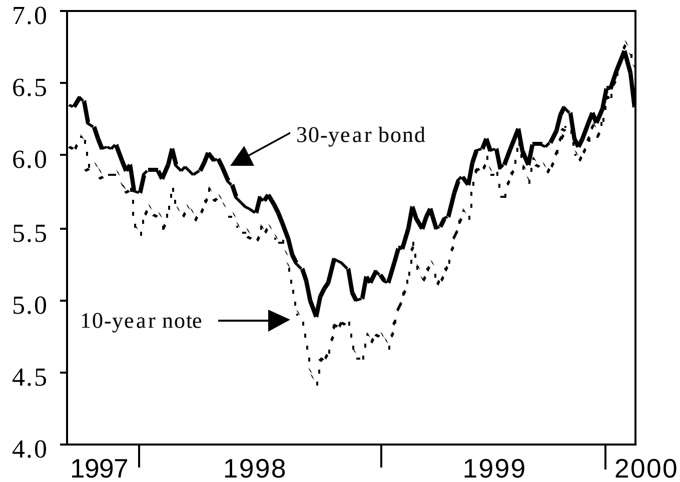
Through 1999, rates on long-term Treasury securities increased as economic growth continued to expand at a rapid pace. The interest rate on the 10-year Treasury note rose from about 4.7 percent at the end of 1998 to almost 6.3 percent at the end of 1999. The rate on the benchmark 30-year Treasury bond rose from 5.1 percent in December 1998 to 6.4 percent in December 1999. In early 2000, yields, which move inversely to bond prices, declined as the price of the securities rose. This was true especially for the 30-year bond. The higher prices largely reflected Treasury's scaling back of new long-term debt issuance and announcement of future buybacks because of growing budget surpluses.

Mortgage rates also increased through 1999 and into 2000. The interest rate on a conventional 30-year fixed rate loan rose from 6.8 percent in January 1999 to 8.2 percent in January 2000. Rising mortgage interest rates reduced housing activity over 1999, but the market remained firm heading into 2000.

Short-term Interest Rates
(Percent)



Long-term Interest Rates
(Percent)



Housing

Housing has remained one of the strongest sectors of the economy in the past few years. Growth was fueled by exceptionally low mortgage interest rates, sound economic fundamentals such as growing employment and income, and wealth effects from rising stock prices. Several indicators of housing activity reached expansion peaks in 1999. Much of this strength was concentrated in the first half, and activity moderated through most of the rest of the year as mortgage interest rates increased. Late in 1999, the pace of activity picked up again and that growth carried forward into 2000.

Sales of new single-family homes posted a new record in 1999 of 904,000. This was about 2 percent higher than the total in 1998, when new home sales rose by almost 10 percent. Resales of existing homes also reached a new record last year, climbing 4.5 percent above the 1998 total to 5.2 million. Home sales were strongest during the early part of 1999, after which the selling pace slowed. Rising mortgage interest rates were largely responsible for the decreasing demand.

The extraordinary level of home sales last year led to a further increase in the number of homeowners. The homeownership rate rose to 67.0 percent in the final quarter of 1999, an all-time record.

Construction of new housing units rose to 1.66 million in 1999, the highest annual total since 1986. Starts of multi-family units declined slightly while starts of single-family homes rose almost 5 percent to a 21-year peak. Construction was strongest in the first quarter of 1999, boosted by an unusually mild winter. Starts tapered off during the spring and summer but surged again late in the year. That strength persisted early in 2000.

Federal budget

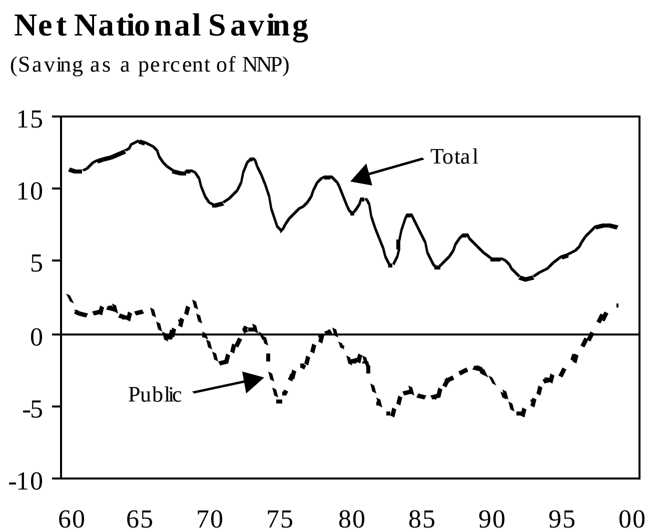
After 28 years of consecutive deficits, the Federal budget posted a second straight surplus in fiscal 1999. The fiscal 1999 surplus was $124 billion, more than $55 billion above the surplus in fiscal 1998. These back-to-back surpluses, the first since 1956 and 1957, resulted in a nearly $140 billion reduction in the amount of Federal debt held by the public. Strong economic growth and passage of deficit reduction programs resulted in these budget surpluses and a steady decline in the deficit since the all-time high of $290 billion in fiscal 1992.

Since 1992, the growth of Federal outlays was contained while receipts were boosted by the rapid expansion in jobs and income and capital gains. In fiscal 1999, receipts rose by a healthy 6.1 percent, although this was less than the 9.0 percent increase in fiscal 1998 and the slowest since 1993. A decline in net corporate tax payments of 2.1 percent was mainly responsible for the slowdown. Growth in individual tax receipts moderated as well. Growth in outlays was held to 3.0 percent, slightly less than the increase in fiscal 1998. Outlays in relation to GDP dipped to 18.7 percent in fiscal 1999, the lowest ratio in 25 years.

The Administration's "Fiscal Year 2001 Budget" forecasts that surpluses will continue. By directing the surpluses toward continued debt reduction, firming the long-run solvency of Social Security and Medicare, and making investments that would enhance the economic expansion, the present $3.6 trillion debt held by the public is projected to be paid off completely by 2013.

Net national saving and investment

Net national saving averaged 7.4 percent of net national product (NNP) in the first three quarters of 1999. This was about the same as the 7.5 percent for all of 1998. (Net saving and NNP exclude depreciation to replace wornout or obsolete equipment, software and structures used in production.) These saving rates are nearly double the post-World War II low of 3.9 percent reached in 1992 and 1993. The Federal budget's swing from large deficits into surplus has more than accounted for the improvement. As a result, the public sector has moved from dissaving equivalent to 5.4 percent of NNP in 1992 to saving of 2.0 percent through the first three quarters of 1999. Despite the progress, net saving still remains well below the 12 percent of NNP averaged in the 1960s.



Note: 1999 based on first three quarters.

Since 1992, private saving has declined as a sharp decrease in household saving has more than offset a gain in corporate saving. Increased wealth, generated by a surging stock market, is an important factor in the reduced desire of households to save out of current income. In the first three quarters of 1999, personal saving was equivalent to only 2.1 percent of NNP, down from 7.4 percent in 1992. Growth of corporate profits, on the other hand, lifted net corporate saving from 2.2 percent of NNP in 1992 to 3.3 percent in 1999.

Net domestic investment (by Government and private industry in structures, equipment, software and inventory) increased. It rose from 5.2 percent of NNP in 1991 to 9.5 percent in both 1998 and the first three quarters of 1999. Investors from abroad financed a large portion of this investment. U.S. net foreign investment swung from +0.3 percent of NNP in 1991 to -3.7 percent in 1999.